How to operationalize import substitution policy: Improving supplier linkages and the role of search obstacles in Ugandan firm markets

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What do we mean by improving linkages?

Supply chain

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- buy inputs from 340 suppliers (orange)
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- sell to 135 firms (green)
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- sell to 1548 firms (purple)
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Supply chain

2 small factories (blue):
- buy inputs from 340 suppliers (orange)
- sell to 135 firms (green)
- sell to 1548 firms (purple)
- buy imports from 96 foreign suppliers from 28 diff countries (black)
Import Substitution - replacing imports with domestic?

- Lessons from elsewhere
  - Latin America - local suppliers not as capable ↑ prices
  - USA and China - trade war with consumers losing
  - EAC - tit for tat - smaller pie
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- Key question: why not already using local supplier?
Plan for presentation

1. What holds back Ugandan firms?
   - Information holds back firms
   - 25% reduction in search costs could lead to an 8% increase in consumer welfare
   - Better firms survival rates

2. How does Uganda reduce firm information constraints?
   - Firm specific support, firm peer learning, internet platforms
How do firms make linkages?

- Colombia: when you reduce search costs, firms make more matches and consumers benefit (Eaton et al., 2016)

- China: when firm managers join business groups they refer each other to clients and suppliers (Cai & Szeidl, 2017)

- Hungary: firms in the same business network add imports from the same country (Bisztray et al., 2018)

- Uganda: firms located in the same location add the same suppliers (Spray, 2019)
10% of Ugandan new connections have an existing customers in the same building
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→ Transfer of information enhances linkages
Survival rates: EAC vs. RoW

Survival rates higher when entry occurs in markets already served by that country’s exporters

Survival in global market higher for exporters that have exported first to regional markets

Source: Brenton (2018)
What is at stake - model results

- Simulate 20,000 firms making search decisions by matching a model to Ugandan data
- Simulate how these firms respond if we were to reduce search costs (e.g. 25%)
- Look at firm and consumer outcomes
Average number of import suppliers $\uparrow$ 20% when search costs $\downarrow$ 25%

Model simulations from Spray (2019)
Proportion of firms which import ↑ 12% when search costs ↓ 25%

Model simulations from Spray (2019)
Average number of domestic suppliers ↑ 1.9% when search costs ↓ 25%

Model simulations from Spray (2019)
Quality $\uparrow 17\%$ when search costs $\downarrow 25\%$

Model simulations from Spray (2019)
Consumer welfare $\uparrow$ 8% when search costs $\downarrow$ 25%

Model simulations from Spray (2019)
Effect of lowering search costs by 25%

Model simulations from Spray (2019)
Effect of lowering search costs by 25%

Model simulations from Spray (2019)
Uganda has a plan

▸ Draft Industrial Policy, 2018, p.17
  “promotion of firm-to-firm backward and forward linkages between small and large scale industries; attracting strategic FDI especially in acquisition of technologies critical for value addition.”

▸ Draft National Industrial Strategy, 2018, p.80
  ▸ “Organize artisanal miners into cooperatives or clusters”
  ▸ “Equip producer cooperatives with skills and tools”
  ▸ “Create linkages between the artisanal miners through signing MOUs with large scale processors to add value and ensure profitable returns”

▸ Buy Uganda, Build Uganda
▸ Local Content Policy
Target 25% reduction in search costs

1. Internet platform support programme (e.g. Ali Baba)
   - e.g. organize quarterly training sessions with the Uganda Manufacturers Association
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2. Firms peer-to-peer learning
   - e.g. organize quarterly peer groups with Uganda business groups
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3. Target key firms in Supplier Development Programmes
   ▶ e.g. establish anchor firm support unit and annual public-supplier meetings
Appendix
China: Business groups tackle information constraints
Cai and Szeidl, 2017

- Commission of Industry and Information Technology (CIIT) organised 1,500 firms into groups of 10 managers
  - Managers held monthly meetings for one year
  - Group leader in charge or organising meetings

- Certificate

- Outcomes: revenue, inputs, ..., customers and suppliers
China: Business groups tackle information constraints
Cai and Szeidl, 2017

Results
- Firm revenue increased by 8.1 percent (profit, inputs, utility costs, linkages, borrowing, management)
- Effects lasted for at least 2 years
- Firms which had better peers experienced larger growth
- Managers referred each other to clients and suppliers

Government intervention led to:
- Learning: managers shared business-relevant information
- Partnering: Managers referred each other to clients and suppliers
Chile: Supplier Development Programme improves quality
Arraiz, Henriquez, and Stucchi, 2012

- CORFO Supplier Development Programme
  - Strengthen management of SMEs through sponsored training, technical advice, technology transfer
  - Programme developed in partnership with large firms
  - CORFO splits up to 50% of cost with a large firm

- Government intervention led to:
  - Increased sales, employment, higher salaries, improved survival rates

- Similar lessons from Ethiopia, Rwanda, Costa Rica etc.
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